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October 30, 2015

BY E-MAIL AND ECF

Hon. Richard J. Sullivan
United States District Judge
United States District Court
for the Southern District of New York
40 Foley Square, Room 2104
New York, New York 10007
sullivannysdchambers@nysd.uscourts.gov

Re: Lehman Brothers Holdings Inc., et al. v.
JPMorgan Chase Bank, N.A., No. 11-cv-06760

Dear Judge Sullivan:

We write as counsel to defendant JPMorgan Chase Bank, N.A. ("JPMorgan") to set forth, as the Court directed in its October 23 Order [D.I. 102], the bases for our position that the bankruptcy court lacks constitutional authority to adjudicate plaintiffs' claims under section 553 of the Bankruptcy Code (the "Section 553 Claims").

As the Supreme Court held in *Stern v. Marshall*, a litigant in a federal proceeding is *presumed* to have a right to adjudication by an Article III judge, and this presumption is overcome only in "limited circumstances." 131 S. Ct. 2594, 2618 (2011). In the bankruptcy context in particular, such circumstances are present only when: (1) the claim is a matter of "public right"; (2) the claim would necessarily be resolved in ruling on a creditor's proof of claim; or (3) the parties unanimously consent to final adjudication by a non-Article III tribunal. *E.g.*, *In re Lyondell Chem. Co.*, 467 B.R. 712, 720 (S.D.N.Y. 2012). JPMorgan has not consented to final adjudication of the Section 553 Claims (or any other claims) in the bankruptcy court; thus, those claims must be finally adjudicated in this Court unless one of the first two conditions is met. Neither is.

Following *Stern* and other Supreme Court precedent, courts in this District have reached "consensus" that the right of a bankruptcy estate "to recover a fraudulent or preferential conveyance is more accurately characterized as a private rather than a public right." *Nisselson v. Salim*, 2013 WL 1245548, at *4 (S.D.N.Y. Mar. 25, 2013) (quoting *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 55 (1989) (internal quotation marks and alterations omitted)). Thus, "the Bankruptcy Court may not ordinarily enter final judgment on avoidance claims." *Id.* (quoting *Sec. Investor Protection Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 2013 WL 67605, at *1 (S.D.N.Y. Jan. 4, 2013) (internal quotation marks omitted)). In ruling on JPMorgan's motion to withdraw the reference in this action, this Court reached the same conclusion. Addressing plaintiffs' claims seeking to avoid and recover transfers under the Bankruptcy Code, the Court held that those claims "were more properly characterized as a 'private' rather than 'public'

right," because they "are intended to 'augment the estate' rather than to obtain a *pro rata* share of the bankruptcy *res*." *Lehman Bros. Holdings Inc. v. JPMorgan Chase Bank, N.A. (In re Lehman Bros. Holdings Inc.)*, 480 B.R. 179, 189, 192 (S.D.N.Y. 2012) (quoting *Stern*).

The Section 553 Claims that plaintiffs have asserted are no different: they seek to recover, for the benefit of Lehman's estate, the very same cash collateral that was the subject of the numerous preference, fraudulent transfer, and common law claims that have already been dismissed or disposed of on summary judgment. The Section 553 Claims are just one more iteration of avoidance claims seeking to claw back JPMorgan's pre-petition collateral on the basis that it allowed JPMorgan to do better than if the collateral had never been received — *i.e.*, that JPMorgan was "preferred." *See, e.g.*, Am. Compl. [D.I. 3-1] ¶ 249 ("JPMorgan is liable for the amount by which the September Transfers enabled it to improve its credit position with respect to LBHI in the ninety (90) days preceding the Petition Date."); ¶ 251 ("The September Transfers are avoidable as impermissible improvements in position . . . and accordingly . . . LBHI is entitled to recover from JPMorgan the value of the September Transfers . . . for the benefit of LBHI's estate."); *see also* Sept. 30 Order [D.I. 100] at 26 ("Plaintiffs claim that . . . the September Transfers should be avoided as wrongful transfers."). Thus, no different from any of plaintiffs' other claims that have been resolved in JPMorgan's favor to date, the Section 553 Claims seek to augment the Lehman bankruptcy estate by clawing back the collateral provided to JPMorgan pre-petition, and are not matters of "public" right that can be finally adjudicated by a non-Article III court. *See Penson Fin. Servs., Inc. v. O'Connell (In re Arbco Capital Mgmt.,*

LLP), 479 B.R. 254, 266 (S.D.N.Y. 2012) ("[A] preference defendant is entitled to have its claim finally adjudicated by an Article III judge.").

As this Court further held in its 2012 opinion, in order for the bankruptcy court to have adjudicatory authority, plaintiffs must "demonstrate that each factual and legal element of [their] claim will be decided in the claims allowance process." 480 B.R. at 190. The Section 553 Claims will not "necessarily be resolved" by the bankruptcy court in ruling on JPMorgan's proofs of claim against the Lehman estate.[1] The Court denied summary judgment on those claims because it did not have the necessary "detail regarding the circumstances surrounding the alleged setoffs" to determine whether they were "in fact setoffs," and whether, if so, they were legally and factually "subject to the safe harbor" for setoff transactions. Sept. 30 Order [D.I. 100] at 27; *see* 11 U.S.C. § 553(a), (b) (providing express safe harbors for setoffs related to swaps, repurchase agreements, and securities contracts). As JPMorgan explained in the parties' October 16 joint letter to the Court [D.I. 101], these issues can be efficiently disposed of by turning first to the applicability of the safe harbors, a determination that has already disposed of every other avoidance claim that plaintiffs have asserted (other than claims alleging actual fraud, to which the safe harbors do not apply).

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[1] In some cases, a preference claim can become part of the process of allowing and disallowing creditor claims in bankruptcy by operation of section 502(d) of the Bankruptcy Code, which requires disallowance of a creditor's claim if that creditor received a voidable transfer and has not returned it. Thus, when section 502(d) applies, the claims-allowance process necessarily requires complete resolution of "the preference issue," such that under familiar rules of res judicata, "nothing remains for adjudication in a plenary suit." *Katchen v. Landy*, 382 U.S. 323, 334 (1966) (analyzing predecessor to section 502(d)). As this Court held in ruling on JPMorgan's motion to withdraw the reference, however, section 502(d) is not applicable to this adversary proceeding "because the parties executed a Collateral Disposition Agreement ('CDA') so providing." 480 B.R. at 192.

But clearly none of the issues that this Court held it must address will be resolved — let alone will they *all* be *necessarily* resolved — in the claim objection proceedings pending in the bankruptcy court, which will determine whether JPMorgan appropriately calculated its recoverable losses under the agreements that governed derivatives, repurchase agreement, and securities lending transactions, as well as whether JPMorgan acted reasonably in liquidating securities collateral pledged by Lehman's broker-dealer subsidiary.[2] Accordingly, the bankruptcy court lacks constitutional authority to finally adjudicate the Section 553 Claims.

In the joint letter, plaintiffs portrayed the remaining claims as raising statutorily "core" bankruptcy issues of whether JPMorgan's claim should be equitably subordinated and whether JPMorgan violated the automatic stay, making no mention of section 553. *See* Joint Letter [D.I. 101] at 5. But these statutorily "core" claims are dependent on a prior determination against JPMorgan on the Section 553 Claims. As the Court stated in the September 30 Order, summary judgment on the equitable subordination claim was denied precisely because the Court had denied summary judgment on the "voidable preferences" claims. Sept. 30 Order [D.I. 100] at 28. Thus, unless plaintiffs succeed on their threshold Section 553 Claims — which, as

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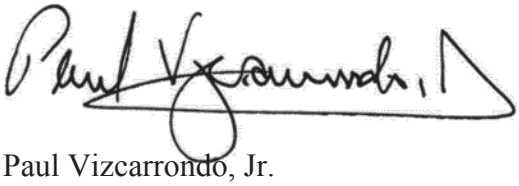
[2] That the resolution of JPMorgan's derivatives and other claims filed against the estate does not subsume the issues raised by the Section 553 Claims is even more evident from the scope of the trial on the Section 553 Claims that plaintiffs envision in the joint letter. In plaintiffs' view, this Court must hear wide-ranging evidentiary submissions as to custom and practice in the collateralization of derivatives transactions, as well as testimony from high-level JPMorgan executives and other evidence concerning whether JPMorgan purportedly acted with an "impermissible purpose of improving its position." As we stated in the joint letter, JPMorgan believes that no such sweeping consideration of custom and practice is required, or even permissible, in determining the applicability of the Bankruptcy Code's safe harbors. *See Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 336 (2d Cir. 2011). But in any event, absolutely none of the issues that plaintiffs seek to raise will be decided by the bankruptcy court in determining the allowed amount of JPMorgan's claims against the Lehman estate.

discussed above, must be resolved in this Court — the so-called "core" equitable subordination claim is moot. Similarly, unless plaintiffs defeat the safe harbor defense with respect to the Section 553 Claims, the claim for violation of the automatic stay necessarily fails, as it is subject to the same safe harbor provisions as the Section 553 Claims. *See* 11 U.S.C. §§ 553(a)(3), (b) (incorporating safe harbors in section 362, the automatic stay provision).

Inasmuch as the bankruptcy court cannot render final judgment on the Section 553 Claims, the interests of judicial economy and efficiency militate in favor of the claims remaining in this Court rather than being referred to the bankruptcy court for a report and recommendation. In this somewhat unusual situation, this Court has considerably greater familiarity with the claims asserted in this adversary proceeding than the current bankruptcy judge, to whom the case was transferred shortly before the withdrawal of the reference.

We are available at the Court's convenience should the Court wish to hear further from the parties.

Respectfully submitted,



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